



INTERNAL AUDIT REPORT

LSG Sky Chefs Inc.
Lease and Concession Compliance Audit

MARCH 1, 2011 – FEBRUARY 28, 2014

ISSUE DATE: August 11, 2015
REPORT NO. 2015-09

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UNTIMELY RESPONSE

TRANSMITTAL LETTER

Audit Committee
Port of Seattle
Seattle, Washington

We have completed a compliance audit of LSG Sky Chefs Inc. We reviewed information for the period March 1, 2011 - February 28, 2014.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend our appreciation to the management and staff of Aviation Business Development Department and Accounting and Financial Reporting for their assistance and cooperation during the audit.



Joyce Kirangi, CPA, CGMA
Internal Audit, Director

AUDIT TEAM	RESPONSIBLE MANAGEMENT TEAM
Jack Hutchinson, Audit Manager	Jim Schone, Director – Aviation Business Development
Roneel Prasad, Auditor	James Jennings, Manager – Aviation Properties Group

EXECUTIVE SUMMARY

AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to determine whether:

1. The reported concession fees were complete, properly calculated, and remitted timely to the Port.
2. The Port and lessee complied with provisions of the Lease and Concession Agreement, as amended.

We reviewed information for the period March 1, 2011 - February 28, 2014. Details of our audit's scope and methodology are on page 5.

BACKGROUND

LSG Sky Chefs, Inc. (Sky Chefs) is a subsidiary of LSG Lufthansa Service Holding AG and currently operates in 54 countries. Sky Chefs provides in-flight catering service, including the preparation and distribution of in-flight foods, beverages, and related services to domestic and overseas airlines at Seattle Tacoma International Airport

The agreement requires two forms of payments from Sky Chefs: rent (Land and Building) and concession fees. Rent is computed based on square footage and is due monthly. Annual rent for Land is \$169,611 and for the building is at \$286,000. Concession fees are 7% of gross revenue for airline operations and 3.5% of gross revenue for non-airline operations.

AUDIT RESULT

The reported concession fees were complete, properly calculated, and remitted timely to the Port. Sky Chefs also complied with the provisions of the Lease and Concession Agreement that we deemed significant to the audit objectives. However, Lessee's response to audit requests was unreasonably untimely. See Findings 1 under the Schedule of Findings.

BACKGROUND

Sky Chefs Inc. and the Port entered into the lease and concession agreement in November 1980. Commencing on March 1, 2011 Sky Chefs renewed its contract for three years ending on February 28, 2014 with 2 consecutive years extension. Instead of exercising Lessee's extension options under this Lease, a new 3-year lease with 2 1-year extension options was executed, effective March 1, 2014.

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FINANCIAL HIGHLIGHTS

KEY FINANCIAL RESULTS FOR LSG SKY CHEFS INC.

AGREEMENT YEAR	REPORTED GROSS REVENUES	RENT	CONCESSION PAID
2011-2012	\$28,564,832	\$455,611	\$1,993,992
2012-2013	34,362,522	455,611	2,399,376
2013-2014 ¹	39,127,474	455,611	2,733,797
TOTAL	\$102,054,828	\$1,366,832	\$7,127,165

Data Source: PeopleSoft Financials
Data Note: ¹ as of 02/28/2014

AUDIT SCOPE AND METHODOLOGY

We reviewed information for the period March 1, 2011 - February 28, 2014. We utilized a risk-based audit approach from planning to testing. We gathered information through document requests, interviews, observations, and data analysis, in order to obtain a complete understanding of the financial requirements of the agreement between the Port of Seattle and Sky Chefs Inc.

We applied additional audit procedures to areas with the highest likelihood of significant negative impact as follows:

- 1) To determine whether the reported concession was complete, properly calculated, and remitted timely to the Port.

- Reviewed the lessee's chart of accounts to determine whether all revenue accounts were included in the reported revenues to the Port.
 - Reconciled the reported revenues to:
 - Revenue Detail Report by revenue items. Additionally, the revenue items were reviewed to determine whether all items subject to the concession fee were included in the reported revenue.
 - Certified Audit Statement of Gross Revenues, which is a statement of revenues independently verified by a CPA.
 - Analyzed deductions to determine whether they were correctly classified and properly deducted from gross concession revenue.
 - Selected risk-based sample of 18 Customer Invoices to determine whether:
 - All revenue items on the face of the Customer Invoice agreed to the amount posted to the Revenue Detail Report.
 - Disallowed deductions reduced revenues subject to the concession fee.
 - Reviewed all payment records for the audit period to determine whether remitted by the required due date.
- 2) To determine whether the Port and the lessee complied with the significant provisions of the Lease and Concession Agreement.
- Reviewed the Certified Audited Statement of Gross Revenues for compliance with the timely and complete submission requirements.
 - Reviewed required insurance coverage in force for the audit period.
 - Determined if the surety bond amount complied with the requirements in the agreement, as amended.

CONCLUSION

The reported concession fees were complete, properly calculated, and remitted timely to the Port. Sky Chefs also complied with the provisions of the Lease and Concession Agreement that we deemed significant to the audit objectives. However, Lessee's response to audit requests was unreasonably untimely. See Findings 1 under the Schedule of Findings.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

FINDING #1

1. SKY CHEFS DID NOT PROVIDE AUDIT RESPONSE TIMELY

Receiving audit records and/or audit clarification from the lessee was difficult and untimely.

As the table below shows, there have been unreasonable delays in receiving lease records and/or providing clarification to audit questions. The delays have caused inefficiencies and duplication of efforts in the audit process. Port management tried to intervene, but it too had little success.

Below are examples of the unreasonable delays

Action	Date Requested	Date Responded	Responded (No. of Days)
Preliminary data request *	July 9, 2014	Dec 4, 2014	148
Requested Additional information *	Dec 16, 2014	Feb 9, 2015	55
Accounts Inquiry *	Feb 17, 2015	Mar 23, 2015	34
Lessee's GL Account Inquiry *	Feb 24, 2015	Mar 23, 2015	27
Account Inquiry *	Feb 24, 2015	Apr 15, 2015	50
Invoice Inquiry *	Feb 27, 2015	Mar 23, 2015	24
Penalty deductions and Incentives from 3 rd Party agreements *	May 11, 2015	July 8, 2015	58

* Port Management Assisted to facilitate

Recommendations:

We recommend Port management:

- Educate and hold the lessee accountable for lack of timely response to audit requests.
- For future contract define lessee's obligations on response timeliness.

Management Response:

In most audits, the lack of a timely response to requests for information from Internal Audit has not been an issue. Unfortunately, in this case, the Lessee underwent significant staff turnover in their accounting department during the course of this audit, contributing to the significant delays noted above. Port management assisted Internal Audit with these requests when informed that Lessee was not responding. With this specific agreement, the Port's only remedy to cure this situation was to place the tenant in formal default of their Lease, a severe measure that is normally reserved for more egregious transgressions.

Port management has begun incorporating language into leases that puts a specific time limit on lessees to respond to information requests from Internal Audit or they are required to pay the full cost for a Port representative to travel to the site where the financial records are maintained. Port management will continue efforts to incorporate this language into all new leases.